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UNCLAS SECTION 01 OF 04 ASUNCION 001342

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SUBJECT: PARAGUAY: CDS CLAIMS `SIGNIFICANT' QUANTITIES OF
OIL AND GAS FOUND IN CHACO EXPLORATION

REF: ASUNCION 1047

1. (U) This cable is sensitive but unclassified. Please
protect accordingly.

Summary

2. (SBU) After a lull of nearly thirty years in hydrocarbon
exploration, a Paraguayan company, CDS Energy, is
undertaking an exploration and drilling project in the
country's Chaco region. In a September 23 meeting with DCM,
company president James Wade said preliminary results show
that significant deposits of oil and gas are present, and
that their extraction and marketing will have a major impact
on the Paraguayan economy. Wade predicts that the
extraction of hydrocarbons will radically change Paraguay's
position from net importer to major regional supplier of oil
and gas. He is cautiously optimistic about the GOP's
capacity to manage this find, and is openly seeking USG
support in safeguarding his company's investment. End
Summary.

Why Paraguay, Why Now?

3. (U) James Wade, Chairman of CDS Energy, met with DCM on
September 23 to discuss the results of his company's recent
tests for oil and natural gas near Paraguay's border with
Bolivia in the country's western Chaco region. Accompanying
Wade was Daniel Morrison, who serves as the company
president. Wade, a Canadian, is a 30-year veteran of oil
and gas exploration, with previous projects in Russia, India
and China. CDS Energy, which is working in cooperation with
local partners, holds exploration rights to just under three
million contiguous hectares across the border from existing
Bolivian and Argentine oil and gas fields.

4. (U) Penzoil carried out the last significant oil and gas
exploration in Paraguay in the early 1970s. According to
Wade, neither the technology nor the economics of the time
were favorable. With the price of oil currently hovering
above USD \$50 per barrel, and with advances in technology
pioneered during Permian Basin exploration, Wade believes
the time is ripe to explore in Paraguay. Beginning in late
July 2005, CDS drilled appraisal wells in areas to the east
of proven reserves in Bolivia, retracing the steps of
earlier exploration with new technology. According to the
company's prospectus, prepared by the London firm City
Capital Corporation, Ltd., the majority of the wells
previously drilled on concessions held by CDS showed
deposits of oil and/or gas. Wade attributed inappropriate
drilling techniques used in prior exploration as "masking"
the true content of the wells. He also said that the data
from prior exploration in the area was fragmented, and that
it had only recently been put together to provide a more
complete picture of potential reserves.

5. (SBU) Regional developments also play into Wade's
calculations. Current Bolivian instability, coupled with
huge potential markets in Brazil and Argentina, mean that a
significant find in Paraguay could position the country to
supplant Bolivia as a major regional supplier of natural
gas. As for the domestic market, Wade envisions a total
revolution in the local energy sector. Paraguay is
presently a 100 percent importer of hydrocarbons. According
to CDS, these imports represent a USD \$200 million negative
in the country's balance of payments. Wade speculated that
the revenues from natural gas alone could exceed those
generated by the Itaipu dam. He is optimistic that better

access to Paraguay's Chaco region will enable CDS to easily market any oil it produces in its test production phase, providing resources for further exploration.

Capital Ideas

16. (U) Wade told econoff that CDS is funded with mainly European capital. Additional capital is being sought on the London Stock Exchange Alternative Investment Market (AIM), which listed the company on September 27. CDS' April 2005 prospectus listed the expected value of three of its oil wells at USD 37 million. The prospectus assigned no value to the wells targeting gas. Based on the results of his test wells, Wade told DCM that his concessions could hold as much as 175 million barrels of oil and 4.4 trillion cubic feet of natural gas. These estimates of gas volumes would indicate a quantity well above that deemed necessary by the prospectus to support exports to neighboring markets in Brazil, Chile and Argentina.

17. (U) CDS' prospectus listed total assets at the end of April 2005 as approximately USD 3.2 million. Based on its expected drilling program of five wells, the company plans to spend approximately USD 16.4 million by the end of 2006. Financing for this expenditure will come through its recent IPO in London. The company has contracted Texas-based Nabors Drilling International to carry out its drilling campaign, and final costs for the program will depend on the performance of each of the five wells planned for this phase.

Charting the Revenue Stream

18. (U) Paraguay's Hydrocarbons Law, Number 779, contains the legal framework for prospecting, exploration and exploitation of petroleum and other hydrocarbons. Title Eight of the law exempts concession holders from government and municipal taxes during exploration. Once production begins, the royalties on the gross production of crude oil are ten percent for 100 to 5000 barrels per day, twelve percent from 5001 to 50,000 barrels per day and fourteen percent for 50,001 barrels and beyond. The law defines a barrel as containing 42 US gallons. Royalties for natural gas, defined as compressed and liquefied hydrocarbons, are twelve percent on total gross production and fifteen percent for any other solid and semisolid hydrocarbons in natural state. Chapter 8, Article 44 of the law requires that royalties be paid in cash within ten days after the reception of the liquidation of the resources. The royalties would be general revenues; the law does not contemplate any type of special fund.

19. (SBU) Comment: Should hydrocarbon finds begin to generate revenue for the Paraguayan treasury, Post will seek to help the GOP institute sufficient safeguards to assure transparent use of the funds. Post's economic working group is already examining this. Post would welcome Department's guidance on ways to encourage transparency and accountability of hydrocarbons revenues, including best practices from other countries, as the potential supply becomes more clear. End Comment.

'A Heads-up To Uncle Sam'

10. (SBU) DCM asked Wade how much CDS has told the GOP regarding its find in the Chaco. Wade replied that he had recently met with the Vice President, but that he had not yet revealed the extent of the reserves he says are present. Wade stated: "This meeting is me saying 'Heads up' to Uncle Sam. We want you to be telling the Paraguayans: 'We know who they are. Treat them well.'" Wade was cautiously optimistic when assessing the GOP's reaction to the find. Wade complained to DCM that Ministry of Public Works officials, including Vice Minister of Mines and Energy Hector Ruiz Diaz, have repeatedly given the press inaccurate information about resources in the Chaco. Morrison noted that CDS has purposefully attempted to maintain a low profile during the project, quietly laying the groundwork for its exploration program and preferring actions to rhetoric.

11. (SBU) During a June meeting with Econoff, VM Ruiz Diaz took a measured approach in discussing the country's hydrocarbon potential. He emphasized the need for careful studies of the data uncovered during the exploration process. Despite his cautious tone, however, he was keen to show to econoff a film produced in December 2004 that chronicles hydrocarbon exploration in Paraguay. This film features footage of Independencia I, the natural gas well drilled by CDS Energy's partner company Primo Cano Martinez Energy. A dramatic nighttime photo of Independencia I, its

methane flare glowing brightly is prominently exhibited in his office.

Next Steps

12. (SBU) Wade predicted to DCM that after intensified exploration in coming weeks, CDS would "soon" begin pumping oil, and that under the terms of Paraguay's hydrocarbons law, the state-owned petroleum entity PETROPAR will buy the oil from the company for market price at the well head. It would then be trucked from the Chaco to PETROPAR's refinery in Asuncion. If sufficient quantities of oil are discovered, Wade stated that he has access to financing sufficient to build a diesel refinery in the Chaco. If the company's gas fields prove large enough to market commercially, Wade also discussed the possibility of bringing in foreign capital to construct a Gas-to-Liquid (GTL) plant closer to Asuncion.

Potential Challenges

13. (SBU) During an earlier meeting with Econoff, CDS President James Wade and his associate Daniel Morrison were frank about some of the potential challenges facing their project. Wade lamented the lack of institutional capacity within the Paraguayan government, stating his doubts that the Ministry of Interior possessed the capacity to even interpret his drilling reports. Morrison also told Econoff that some local environmental groups were reflexively opposed to any hydrocarbon exploration. Defending the thoroughness of CDS' environmental impact assessments, Morrison told Econoff "We documented plants and animals that the environmental groups didn't even know about."

14. (U) During his meeting with DCM, Wade noted that in addition to selling his project to prospective investors, he was tasked with "selling Paraguay." Morrison noted that the recent expropriation of land around the community of Puerto Casado (reftel) sent a bad signal to business people interested in investing in the country, stating "It was the worst thing the GOP could have done."

15. (SBU) CDS has retained both local legal counsel and a government relations specialist, whom Wade refers to as "my apostle", to help the company navigate the local bureaucracy. In a meeting with Emboffs, Morrison stated that CDS had not been the target of extortionists, and that the company would not pay bribes. In part, Wade believes that many Paraguayans, including officials, were dismissive of oil and gas potential because of past exploration failures and prevailing myths about the inaccessibility of the Chaco region. For that reason, Wade believes the CDS project has received less than serious attention from some people. Both men noted that other companies have acquired neighboring oil and gas concessions after CDS, in hopes of capitalizing on any discovery.

Comment

16. (SBU) The discovery of significant hydrocarbon reserves in Paraguay (if true) the investment that would follow, and the resulting increase in government revenues, would have profound economic and political implications. While CDS's capital primarily comes from the U.K., they already employ a U.S. subcontractor and would likely rely heavily on U.S. suppliers for any significant production. Post remains in close contact with CDS and will report on further developments as the company turns from exploration to production. Wade is keen to keep the USG informed, and to show the GOP the Embassy's interest in his company. End Comment.

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